NOTES.

THE QUANTITY THEORY AND ITS CRITICS: A REJOINDER.

MR. CLOW'S thoughtful attempt to rehabilitate the quantity theory in the earlier pages of this JOURNAL suggests a few points in which he seems to me to be in error, or to have mistaken the issue. Some of these points are disconnected, and may be taken seriatim:

1. The quantity theory was not, at least so far as I am concerned, opposed because it was used as the basis of bimetallism. Although given prominence by the bimetallic discussion, it had long failed to satisfy the reason, or explain the facts. Its examination was taken up because it seemed to be a defective part of the economic fabric, and not merely because it was connected with a passing phrase of monetary agitation.

2. The opponents of the quantity theory can scarcely with accuracy be described as the "credit school," on the ground that they lay emphasis on credit as a medium of exchange. The most extreme advocate of the quantity theory, General F. A. Walker, admitted the full effect of credit as a medium of exchange; but yet he held that such offer of purchasing power had no effect on general prices.

3. On the general field of value, in various parts of his paper, Mr. Clow raises questions which cannot be adequately answered in full here. In the treatment of the quantity theory, in my *Principles of Money*, I tried to show that price was a relation between goods and some standard—and not between goods and other things serving as a medium of exchange—and that, whatever the theory of value on which the exchange between goods and the standard was arrived at—whether solely cost of production, or cost and utility, or solely marginal utility—the question of price and the quantity theory could be discussed independently of theories of value. Nor do Mr. Clow's suggestions lead me to doubt the essential correctness of my position in that respect. But, as concerns the theory of value, the critic seems in my opinion, to rely quite too much on the soundness of the subjective and utility theories of value. The time has come to sound a loud warning as to reasoning based on the validity of the utility theory of value.

Indeed, Mr. Hobson's conclusions on this point in his *Economics of Distribution* (pp. 79–92) are eminently sane. Therefore, when Mr. Clow discourses about the value of a "dollar" being dependent on a psychological basis; that it has a real entity in itself, quite irrespective of commodities; and that an artificial standard may exist only in "the minds of the people"—I am unable to understand or follow him; and I am forced to believe that he is speaking of some other concept than exchange value. Price, so far as I can think of it, is a case of exchange value. Therefore, I must discard all this part of his paper as quite aside from the point. When he says that value is not physical, he is far away from exchange value.

4. In trying to harmonize the quantity theory with the effect of redemption on inconvertible paper money, the critic seems to me to accept unconsciously the validity of the latter force as dominating on the value of paper money. When it was known that a paper which had depreciated 50 per cent. was to be redeemed without question at par in specie, Mr. Clow says: "as a speculative investment it would at once be worth par less discount." This is the whole case. The value at par less discount was given it by the certain redemption, and not at all by something which might happen later—such as details as to how much of the paper would be kept in circulation after its value had been raised to par. The quantity theory, by his own showing, comes into the case only after the value of the paper has already been fixed at par less discount by the principle of redemption.

5. The opponents of the quantity theory are charged with a failure to understand that an article may have utility simply as money; they are charged even with believing that a demand for a standard commodity does not affect its value. In these points Mr. Clow has incorrectly understood me, at least. Again and again I have insisted that the demand for the standard, whether in the arts or as money—in any function—affects the value of the standard, and thus affects general prices. When he speaks of our thinking that the demand in the arts is the only real demand, he has misread the clearest statements to the contrary. The demand for the standard in any form whatever is, however, but one of several forces affecting the value of the standard and the level of prices. If gold is used in California as a medium of exchange, that use is a demand for gold, and with other forces has an influence on the world's value of gold, and on the level of gold prices.

6. The assertion that gold, from 1875 to 1890, did not increase correspondingly with the production of goods is neither proved, nor

is its connection with prices shown. I, for one, do not understand that an excessive fall of prices was obviated by the growth of the banking habit. That fall was prevented by a supply of gold out of proportion to the new demand for it as money. If he holds that the "credit school" believes credit has no effect on prices, how can he claim that they think the fall of prices has been obviated by something which has no effect on prices?

7. The "habit of making exchanges at a given level" is a suggestion applicable, not to modern markets, but to some primitive or isolated community. Merchants and manufacturers in our age and country have no such habits. Nor, if more payments are to be made, does it follow that more gold must be used and prices must be lowered; because the demand for gold is only one of several forces affecting prices. Other forces touching prices may entirely reverse the influence of the demand thus indicated.

8. The table of figures giving the relation of gold to transactions by checks and similar devices is wholly inconclusive as a piece of inductive reasoning.

9. The critic completely mistakes my position as to the relation of banking reserves to prices. Nor can I understand what he means when he says that a rise of the rate of interest and a rise in the price of securities will result in a general rise of prices. The arts of production have little direct connection with the manipulations of Wall street. The changes in reserves, and their relations to the rate of interest, I discussed at length in my volume.

10. With a gold standard, the critic simply assumes *a priori* that an increased demand for a medium of exchange means an increased value of gold. The distinction between the function of the standard and of the medium of exchange is not sufficiently regarded. Nor does Mr. Clow give any proof of his position. Also, he probably never intended to speak of "bank clearings" which are the results of the deposit currency (a medium of exchange) as themselves a medium of exchange. It must have been a slip of the pen.

11. His conclusion that goods and gold are offset against each other, as a means of arriving at price seems wholly unsupported by facts or by reason.

12. If the gold held in reserves is ascribable to the demand for a medium of exchange, of course, *pro tanto* that is a demand for gold; but such a demand bears no fixed proportion to the work done in exchanging goods.

13. The distinction between the "unit of value" and the "standard of value" is too refined for my intelligence. "The increase of credit lowers the value of the unit, while the increased demand for gold raises the value of the standard." Under free coinage, how a change in the value of the standard can be prevented from changing the value of the unit passes my understanding.

14. It cannot, I think, be successfully established that the fall of prices in 1893 was due to the demand for gold.

15. In regard to the use of the quantity theory in explaining international trade, Mr. Clow suggests that we have tried to overthrow the old theory, and have given no explanation in its place. I venture to believe, with Professor Nicholson, that the old theory has not been overthrown, but more correctly stated by eliminating the false quantity theory. As given in the past, it could not possibly explain the facts; and I modestly suggest that my constructive discussion of international trade does provide an explanation in place of the one discarded. Every merchant and exporter, also, can bear witness to the fact that scarcity, or high taxes, or anything which increases the expenses of production of our exports acts directly to check our exports, without waiting for a movement of the precious metals. Moreover, Mr. Clow himself gives a case in which the costs of carriage of perishable articles have a direct influence on their prices, quite irrespective of the quantity of the circulating medium.

16. In the explanation of foreign trade and exchange he also seems to overlook the operations of the rate of interest and the movement of floating capital between financial centers.

17. Again, when he declares there can be an increase of normal credit greater in amount than the increase of goods, he is not using normal credit in my sense, but in the sense of abnormal credit.

18. In believing that the division of occupations causes more exchanges of goods, he seems to me to overlook the greater offset in the elimination of exchanges arising from improved methods of doing business.

19. Finally, to disprove the quantity theory, he claims (1) that we must show monetary habits to be immediately adjustable. That is aside from the point. Price is an exchange relation between goods and the standard. Grant that monetary habits are slow of adjustment; that is only one detail of the operations by which the demand for gold could affect gold prices; but demand for gold is not synonymous with the demand for a medium of exchange. Changes in the medium of

exchange can take place without directly affecting prices. (2) The law of value regulating the existing stock of gold does not change the fact that price is the exchange relation between gold and goods, and not the relation between goods and things other than gold. (3) The equilibrium of buying and selling is maintained according to the exchanges of goods against goods in which money serves only a subsidiary part as a medium of exchange.

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AN INCREASE IN GOLD AND THE PRICE-MAKING PROCESS.

THE quantity theory of money has been assailed at various points in recent years, and there is a growing conviction in some quarters that the time-honored theory of Ricardo and Mill is wholly wrong. Without attempting to state all the points at issue, attention will be directed to one of the main questions.

Let us suppose that, owing to the discovery of richer mines or the invention of better mining machinery, there is an increase in the supply of gold in sufficient quantity to raise the general level of prices. According to the older view, this change is brought about by the increase of gold in circulation ; that is, by the offer of gold for goods. According to the new view, it is brought about by the fall in the value of gold in the arts.

The argument of the later writers may be briefly stated as follows : The new gold could not increase the circulation, because, the volume of business and the habits of the community remaining the same, no more money would be wanted. Hence, the gold must find its way into the arts. There being no increase in the demand for gold in the arts, any attempt on the part of the holders of gold to dispose of their commodity in that quarter would depress the value of gold in the arts, and the value of the coin would fall as a consequence.[1]

The first point in this argument to be considered is the statement that the circulation cannot be increased. Now, it can hardly be denied that if the mine-owners produce more gold than formerly, they could offer it in exchange for goods, and that in the ordinary course of events they would do so. Nor could it be denied that each person who receives the extra gold could and would in turn offer it for goods. The

[1] LAUGHLIN, *Principles of Money*, pp. 339–42. See also GIFFIN, *Case Against Bimetallism*, pp. 81–98.